

Message Text

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C O N F I D E N T I A L SECTION 01 OF 02 LONDON 07544

LIMDIS GREENBACK

DEPARTMENT PASS TREASURY AND FRB

E.O. 11652: XGDS-1

TAGS: EFIN, UK

SUBJECT: UK TREASURY VIEWS ON INTERNATIONAL MONETARY
QUESTIONS AND UK BALANCE OF PAYMENTS OUTLOOK

REF: LONDON 6281

SUMMARY: UK TREASURY SOURCES BELIEVE DISCUSSIONS ON INTERNATIONAL MONETARY QUESTIONS MAY CONTINUE AT A NO PROGRESS LEVEL BETWEEN MAJOR PARTICIPANTS UNTIL MINISTERS MEET AT THE IMF INTERIM COMMITTEE SESSION IN JUNE. OUTLOOK FOR UK BALANCE OF PAYMENTS IS SEEN AS BETTER THAN EXPECTED, BUT POSSIBILITY OF A DISASTER SCENARIO CANNOT BE DISCOUNTED. END SUMMARY.

1. UK TREASURY SOURCE RESPONSIBLE FOR EC MONETARY COMMITTEE, IMF AND G-10 SUBJECTS REPORTS VERY LITTLE PROGRESS MADE AT MAY 9 EC MONETARY COMMITTEE SESSION IN DUBLIN. IT WAS AGAIN 8 TO 1 WITH FRANCE THE ODD MAN OUT. FRENCH CONTINUE TO MOVE AWAY FROM CONCILIATORY POSITIONS ADOPTED IN JANUARY; FRENCH PERFORMANCE AT THE MAY 9 SESSION WAS DEEMED COMPLETELY RECIDIVISTIC. AT CONCLUSION OF THE SESSION, FRENCH DELEGATE MADE AN INTERVENTION TO EFFECT THAT IT WAS NECESSARY FOR THE EC TO ADOPT A COMMON POSITION IN
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CONFRONTATION WITH THE US. AFTER THIS, UK DELEGATE INTER-

VENED TWICE WE ARE TOLD MAKING GENERALLY RUDE COMMENTS ABOUT THE FRENCH POSITION, ADDING THAT MOST EC MEMBERS HAVE MORE DIFFICULTIES ON THE SUBJECTS DISCUSSED WITH ONE OF THEIR OWN PARTNERS THAN WITH THE US. EMMINGER APPARENTLY AMUSED AND IN GENERAL AGREEMENT WITH THE UK INTERVENTION. OORT OF THE NETHERLANDS SAID TO HAVE PRODUCED A REALISTIC EC PAPER ON MAJOR UNSETTLED POINTS IN MONETARY REFORM.

2. UK DOES NOT CONSIDER THAT ANY PROGRESS WAS MADE IN DISCUSSIONS IN PARIS LAST WEEK ON MONETARY REFORM AND EXPECTS THAT THE OUTSTANDING ISSUES WILL HAVE TO BE SETTLED BY MINISTERS IN JUNE. GIVEN THE INEPTNESS OF JAPANESE FINANCE MINISTER OHIRA, CHAIRMAN OF THE G-10, UK BELIEVES IT WILL BE UP TO INTERIM COMMITTEE CHAIRMAN TURNER TO BRING ABOUT A COMPROMISE IF ONE IS POSSIBLE. UK PLANS TO HAVE BILATERAL DISCUSSIONS WITH CANADIANS TO CONSIDER POSSIBLE SCENARIOS AND SOLUTIONS, FOLLOWING UP ON HEALEY-TURNER BILATERAL RECENTLY HELD IN LONDON DURING TURNER'S VOYAGE TO MIDDLE EAST.

3. UK AND BY IMPLICATION DURING DISCUSSION, MOST OTHER EC MEMBERS, STILL HAVE SOME PROBLEMS WITH THE US ON THREE COUNTS, I.E, QUOTAS, RULES FOR FLOATING, AND INTEREST RATE SUBSIDY FOR THE OIL FACILITY. ON QUOTA QUESTION, UK STILL CONSIDERS THAT THE US WILL HAVE TO MOVE BELOW 20 PER CENT, ALTHOUGH NOT NECESSARILY AS FAR DOWN AS SOME IN EC HAVE SUGGESTED IN A QUOTA REDISTRIBUTION THAT WOULD BE PART OF A LARGER PACKAGE (SEE PARAS 2-3 REFTEL). NO SPECIFIC COMPLAINT MADE ABOUT US POSITION ON FLOATING EXCEPT THAT AS THE FRENCH HAVE RETREATED FROM THEIR POSITION IN ONE DIRECTION, THE US APPEARS TO HAVE GONE IN THE OTHER. SOURCE ADMITTED THAT EUROPEANS HAD MISJUDGED THE STRENGTH OF US OPPOSITION TO INTEREST RATE SUBSIDY ON THE IMF OIL FACILITY. CHANCELLOR HEALEY AND OTHERS HAD APPARENTLY CONSIDERED US WOULD COMPROMISE ON THIS POINT SINCE THE SUM INVOLVED IS RELATIVELY SMALL (SOURCE THOUGHT ROUGHLY 55 MILLION DOLLARS AND SPREAD OVER A SEVEN-YEAR PERIOD) CHANCELLOR REPORTEDLY IRRITABLE THAT SO MUCH TALK HAS PRO-

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DUCED SO FEW RESULTS. SOME H.M. TREASURY OFFICIALS INVOLVED IN NEGOTIATIONS DO NOT EXCLUDE POSSIBILITY THAT FRENCH WILL REFUSE TO AGREE ON MAJOR POINTS. THAT OTHER MAJOR COUNTRIES WILL HAVE TO PROCEED WITHOUT FRANCE, AND THAT FRANCE WILL QUIETLY ACCEPT DECISIONS TAKEN SOME MONTHS LATER.

4. ON UK BALANCE OF PAYMENTS OUTLOOK, SOURCES CONSIDER

THAT THE BASIC UNDERLYING TREND AND FINANCING PROSPECTS
ARE FAVORABLE PROVIDED THAT THE EC REFERENDUM VOTE IS POSI
TIVE AND THAT THE WAGE EXPLOSION CAN BE GOTTEN UNDER CON-

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C O N F I D E N T I A L SECTION 02 OF 02 LONDON 07544

LIMDIS GREENBACK

TROL. SOURCES NOTE CHANCELLOR'S BUDGET SPEECH EXPECTED AN
IMPROVEMENT IN CURRENT ACCOUNT BALANCE IN 1975 OF ROUGHLY
ONE BILLION POUNDS, I.E., AN IMPLIED REDUCTION FROM 3.8
BILLION POUNDS IN 1974 TO 2.8 BILLION IN 1975. TREND IN
CURRENT BALANCE DURING FIRST FOUR MONTHS 1975 SHOWING DEF-
ICIT OF 490 MILLION POUNDS OR 1.5 BILLION POUNDS AT ANNUAL
RATE PROBABLY CANNOT BE SUSTAINED. MUCH OF THE IMPROVE-
MENT RESULTS FROM RUNNING DOWN INVENTORIES WHICH WILL BE
REBUILT, ADDING TO IMPORT DEMAND. ON THE OTHER HAND, THE
ANNUAL DEFICIT COULD STILL BE CONSIDERABLY BELOW 2.8
BILLION.

5. IN REPLY TO QUESTION ABOUT ITS FINANCING, SOURCE SAID
HM TREASURY CONSIDERS THAT THE OUTLOOK IS QUITE GOOD.
FOLLOWING RATIONALE WAS OFFERED. 3.8 BILLION POUND DEF-
CIT LAST YEAR REQUIRED ONLY 3.2 BILLION IN FINANCING;

CONSIDERABLE NORTH SEA OIL DEVELOPMENT IS REFLECTED
IN IMPORT FIGURES BUT THIS IS OFFSET BY RELATED DIRECT
INVESTMENT CAPITAL INFLOWS. SAME GENERAL MAGNITUDE OF
NORTH SEA RELATED IMPORTS AND OFFSETTING CAPITAL INFLOWS
IS EXPECTED THIS YEAR, REDUCING AMOUNT OF CURRENT ACCOUNT

FINANCING NECESSARY TO THE 2 BILLION POUND LEVEL, PERHAPS AS LOW AS 1.6 BILLION POUNDS. UK ALREADY ADDED ONE BILLION DOLLARS TO ITS RESERVES EARLY IN THE YEAR FROM REMAINDER OF MARCH 1974 EUROBORROWING; THERE IS ANOTHER TRANCHE OF THE IRANIAN 400 MILLION DOLLAR BORROW-
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ING TO BE TAKEN; CONSIDERABLE HIDDEN RESOURCES EXIST IN DOLLARS SOLD FORWARD BY THE BANK OF ENGLAND; AND BOTH KUWAIT AND SAUDI ARABIA SHOW CONTINUING WILLINGNESS TO MAKE 50 TO 100 MILLION DOLLAR PLACEMENTS IN PUBLIC SECTOR BORROWING, WITHOUT ANY FANFARE OR IDENTIFICATION OF THEIR INVOLVEMENT. NEITHER SAUDI ARABIA NOR KUWAIT WISHES TO ENGAGE IN LARGE IDENTIFIED LOANS BUT RATHER HAVE INDICATED PREFERENCE FOR THE SMALLER BUT CONTINUING PLACEMENTS. ALTHOUGH ORDERS OF MAGNITUDE COVERED A WIDE RANGE AND DISCUSSION COULD NOT BE MORE PRECISE THAN ABOVE ACCOUNT, SOURCE SAID UK TREASURY STAFF CONSIDER THAT 60 - 65 PERCENT OF REQUIRED CURRENT ACCOUNT FINANCING FOR 1975 MAY ALREADY BE IN HAND, BASED ON OPTIMISTIC ASSUMPTIONS.

6. ASSUMING THAT THE JUNE 5 REFERENDUM VOTE IS POSITIVE, UK TREASURY SOURCES EXPECT SOME MAJOR GOVERNMENT ACTION TO DEAL WITH THE WAGE EXPLOSION, PERHAPS COMING IN JULY. BETWEEN ANNUAL WAGE ROUNDS. ALSO EXPECTED ARE MINISTERIAL CHANGES THAT WOULD PLACE ANTI-MARKETEERS IN LESS RESPONSIBLE POSITIONS.

7. THE DISASTER SCENARIO FOR WHICH UK TREASURY DOES NOT HAVE CONTINGENCY PLANS AND WHICH IT DOES NOT IN ANY CASE THINK CAN BE RESOLVED THROUGH FOREIGN BORROWING WOULD COME IF THE EC REFERENDUM VOTE WERE NEGATIVE AND THE GOVERNMENT UNABLE TO BRING INFLATION UNDER CONTROL. HM TREASURY IS PREPARED TO SEE THE POUND FALL, ALTHOUGH IT THINKS THE CURRENT 25 PERCENT WEIGHTED DEPRECIATION LEVEL ABOUT RIGHT FOR THE MOMENT; IT IS HAVING SECOND THOUGHTS ABOUT THE APPROPRIATENESS OF THE TRADE-WEIGHTED MEASURE GIVEN THE IMPORTANCE OF CAPITAL MOVEMENTS, ESPECIALLY WITH THE DOLLAR, IN DETERMINING THE ACTUAL MARKET RATES. POINTS MADE IN PARA 6 REFTTEL AGAIN REPEATED, ESPECIALLY CONCERNING PRESS REPORT WHICH FORCED CHANCELLOR TO MAKE STATEMENTS THAT HE DOES NOT WISH TO SEE POUND FALL FURTHER IN MARKETS BUT WHICH ADDED THAT THERE WOULD BE DOWNWARD PRESSURE ON RATE UNTIL DOMESTIC INFLATION BROUGHT UNDER CONTROL. H.M. TREASURY SOURCES WE HAVE SPOKEN TO THINK IT BETTER THAT POUND SHOULD DECLINE GRADUALLY RATHER THAN HAVE A PRECIPITOUS DROP.

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